Accounting Standards Board
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Submitted electronically via www.ifrs.org

International Accounting Standards Board
30 Cannon Street, 1st Floor
London EC4M 6XH
United Kingdom

Dear Sirs:

Re: A Review of the Conceptual Framework for Financial Reporting (DP/2013/1)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the Discussion Paper, *A Review of the Conceptual Framework for Financial Reporting*, issued in July, 2013.

The AcSB is Canada's national accounting standard setting body, which has adopted a strategy of importing IFRSs into Canada for publicly accountable enterprises. The AcSB consists of members from a variety of backgrounds, including financial statement users, preparers, auditors and academics. Additional information about the AcSB can be found at www.frascanada.ca.

The AcSB consulted widely on the Discussion Paper, including with its Conceptual Framework Discussion Group, User Advisory Council and Academic Advisory Council, as well as outreach to Canadian stakeholders, individual members of the AcSB and its staff. The Conceptual Framework Discussion Group included preparers, auditors, users and academics and discussed the full proposals over multiple meetings. The outreach activities included holding, in conjunction with the IASB, a roundtable with Canadian stakeholders. This letter represents the views of the AcSB after considering the input received from these consultations. These views are not formal positions of the AcSB, which are developed only through due process.

In our response to the 2011 Agenda Consultation, we strongly supported a project to complete the IASB's *Conceptual Framework*. We are therefore pleased that the IASB reactivated the conceptual framework project and developed a Discussion Paper. We agree that the project should focus on "updating, improving and filling in gaps rather than fundamentally reconsidering all aspects of the *Conceptual Framework*". Focusing on the items listed in paragraph 1.7 of the Discussion Paper, bringing forward the exposure draft on "reporting entity" and not reopening Chapters 1 and 3 of the current *Conceptual Framework* are consistent with this approach.

Understandably, the Discussion Paper includes much material that is not conceptual, in order to clarify the implications of alternatives and differences between them as well as to describe current practices. As a result it is unclear what material from the Discussion Paper the IASB intends to include in the *Conceptual Framework*. For some parts of the Discussion Paper, this has made it difficult to determine how best to provide constructive comments. We think it is important that the *Conceptual Framework* be focused at the conceptual level and include only concepts that have a sound theoretical basis. This will provide an integrated set of concepts that is useful to the IASB in developing standards and to preparers, auditors and others in determining accounting policies for transactions and events not specifically addressed by a standard. For the reasons identified in our response to Question 1, we think that assisting preparers, auditors and other stakeholders is an equally important purpose of the *Conceptual Framework*. Our detailed comments specify the conceptual principles that we think should be part of the *Conceptual Framework* and the other material that, where relevant, should be dealt with outside of the *Conceptual Framework*.

The IASB intends to complete the *Conceptual Framework* by the end of 2015. We think that certain of the Discussion Paper topics are well advanced and could be completed in this timeframe. Specifically, this would include most of the topics in Sections 2, 3 and 4 on asset and liability definitions, recognition and derecognition. However, we think that the topics in Sections 5 to 8 on liabilities and equity, measurement, presentation and disclosure and other comprehensive income require significant further development before being ready for an exposure draft. Parts of these chapters look more like an amalgam of current practice, rules and application guidance rather than concepts level material, which is not appropriate in a *Conceptual Framework*. (Specific comments on each of these sections of the Discussion Paper are provided in the Appendix to this letter.)

We recommend that the IASB proceed on the proposed schedule with the first group of topics. Addressing these topics would be of significant benefit in resolving a number of issues that arise in relation to current standards and would help some important standard-setting projects to move forward.

For the second group of topics we recommend that additional targeted research as proposed in the Appendix start as soon as possible. We think that this research should include the concepts associated with unit of account to ensure that future standards address this fundamental and pervasive issue in a systematic and consistent manner. Our response to Question 24 identifies some aspects of unit of account that should be considered. We recognize that this additional research will delay completion of the *Conceptual Framework* but, as noted above, we think it is critical that the *Conceptual Framework* be focused on concepts and that these have a sound theoretical basis.

Consistent with a focus on concepts, we do not believe the *Conceptual Framework* should contain exceptions. A conceptual framework should be aspirational in nature, stating clearly the concepts the IASB thinks should ideally underlie accounting standards. We recognize that in certain circumstances it may not be possible to fully apply the *Conceptual Framework* but these decisions should be dealt with explicitly at a standards level, not in the *Conceptual Framework*. As identified in our response to Question 1, we think that Chapter 3 of the *Conceptual Framework* already provides criteria for such decisions.

The Appendix to this letter responds to the questions posed in the Discussion Paper and provides some additional comments at the end.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively, Peter Martin, Director, Accounting Standards (+1 416 204-3276 or email pmartin@cpacanada.ca) or Rebecca Villmann, Principal, Accounting Standards (+1 416 204-3464 or email rvillmann@cpacanada.ca).

Yours truly,

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APPENDIX

Section 1 Introduction

Purpose and status – Question 1

1. We agree that the long list of possible uses in the current *Conceptual Framework* is unhelpful when developing a revised conceptual framework. However, we are concerned that the Discussion Paper does not reflect the importance of the *Conceptual Framework* to preparers, auditors and other stakeholders that need to determine the appropriate accounting for a transaction or event that is not addressed in a standard. Preparers and their professional advisors are usually the first to have to deal with new accounting issues as they enter into new types of transactions that are not addressed by the standards. The *Conceptual Framework* is important to them for this reason. Other stakeholders have expressed similar views on the importance of the Framework to them. Therefore we think that the secondary purpose in paragraph 1.28 of the Discussion Paper should be equal in importance to assisting the IASB in developing and revising IFRSs.

2. Consistent with the above, we do not agree with the statement in paragraph 1.29 that some aspects of the *Conceptual Framework* should not be used by parties other than the IASB. If a concept is valid and appropriately expressed it should be available to anyone, whether it is the IASB developing a new or revised standard or a preparer or auditor considering what an appropriate accounting policy should be in the absence of a standard that applies to a specific transaction or event.

3. We agree that the IASB will sometimes need to issue a new or revised standard that conflicts with some aspect of the *Conceptual Framework*. This will often be the result of the need to make a trade-off between different requirements rather than simply a conflict with one specific part of the *Conceptual Framework*. The possibility of departures from full compliance with all aspects of the *Conceptual Framework* is already acknowledged in Chapter 3. For example, paragraph QC 34 already states that "sometimes one enhancing qualitative characteristic may have to be diminished to maximize another qualitative characteristic". Paragraphs QC 35 – 39 discuss the cost constraint. A decision to issue a standard that conflicts with some aspect of the *Conceptual Framework* should be made only after careful consideration of the qualitative characteristics and the costs and benefits of alternatives.

4. We think that the *Conceptual Framework* should not address this issue to any greater extent than already exists in Chapter 3. The *Conceptual Framework* should focus on the concepts that should ideally underlie accounting standards. Any departure from the *Conceptual Framework* should be a standards level decision. This is a due process issue that should be addressed in the Due Process Handbook issued by the IFRS Foundation. We agree that due process should require an explanation of a departure from some aspect of the *Conceptual Framework* in the Basis for Conclusions for that standard.

Section 2 Elements of financial statements

Definitions – Question 2

5. We support these definitions and think they represent a significant improvement that will address the primary problems experienced in practice with the existing definitions. We suggest no further changes.

6. We note that the phrase "as a result of past events" in the definitions could be included in the supporting guidance to the definitions instead. This phrase is problematic to some who think that retaining it in the definitions creates a requirement to search for and identify the past event that gave rise to an asset or liability. We think it is not necessary to identify the past event in order to determine whether an asset or a liability exists and struggle to understand how a present asset or liability can exist without a past event. However, we acknowledge that the reference to past events in the definitions may be helpful to some. In particular, looking at which past event gave rise to an asset or a liability in practice is useful to determine how to portray that event in financial statements, as explained in paragraph 2.16(c) of the Discussion Paper. We recommend that the Exposure Draft explain the IASB's rationale for retaining this phrase in the definitions.

Uncertainty and probability threshold – Question 3

7. We agree that removing the word "expected" from the definitions and replacing it with the notion of "capable" represents an improvement. Although some stakeholders question whether capable still contains an implicit probability threshold, we acknowledge that a better word hasn't been found.

8. Overall, we agree with the IASB's preliminary views on uncertainty in paragraphs 2.35 and 2.36 of the Discussion Paper. Specifically, we agree that:

   (a) A probability threshold should not be part of the element definitions, for the reasons discussed in paragraph 2.35(a).

   (b) Existence uncertainty is rare when considering types of assets or liabilities. The most obvious example is litigation as a low-probability/high-severity event. The IASB should decide at a standards level how to deal with assets and liabilities with significant existence uncertainty, as explained in paragraph 2.35(b).

   (c) A probability threshold should not be included in the recognition criteria. Uncertainty should not, by itself, determine whether an asset or liability is recognized. Instead, uncertainty should affect the measurement, as explained in paragraphs 2.35(c) and 2.36.

Elements for other statements – Question 4

9. We think that the *Conceptual Framework* should be complete and include definitions of elements of all financial statements, including the statement of cash flows and statement of changes in equity, as identified in paragraph 2.52 of the Discussion Paper. We agree that there have not been significant problems in practice with the existing framework material in the definitions of income and expenses (including gains, revenue, losses and expenses). Therefore we agree with the IASB's approach to carry forward the existing material unchanged, as described in paragraphs 2.37 to 2.46.

Section 3 Additional guidance to support the asset and liability definitions

Constructive obligations – Question 5

10. We agree that the revised *Conceptual Framework* should retain a definition that encompasses both legal and constructive obligations. However, we think paragraph 4.15 of the existing framework that states that obligations may also arise "from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner" should be revised because this statement is too broad and vague.

11. The notion of a constructive obligation is particularly confusing under different legal frameworks. In the context of some legal frameworks, there may be no need to separately identify a constructive obligation and doing so causes confusion. Some stakeholders think that constructive obligations are one type of liability that could result from applying the more general liability definition. However, we accept that a broader definition that encompasses constructive obligations is necessary because obligations in other jurisdictions may be enforceable by religious strictures or local customs rather than by law.

12. We agree that the additional guidance in paragraph 3.50 of the Discussion Paper could be helpful to clarify the distinction between a constructive liability and economic compulsion. Conceptually, if an entity has an obligation, generally, another party (or the public at large) should have a corresponding right. Looking at the concept from this perspective may be useful in determining whether a present obligation exists.

Meaning of "present" – Question 6

13. We agree with the IASB's tentative decision to reject View 1 for the reasons stated in paragraph 3.96 of the Discussion Paper.

14. We think that paragraphs 3.63 to 3.97 are the one exception to our previous statement that Sections 2 to 4 are well advanced. We think that the concepts underlying Views 2 and 3 need further work. In particular, the implications of the two views on royalties and executory contracts need to be considered. Also, rather than focusing on the notion that conditions may remain, we think any further work on View 3 should focus on the concept

in paragraph 3.85 that "[a]s soon as the entity has received the resource or conducted the activity, it no longer has complete discretion to avoid a future transfer." Given that we agree with neutrality, we struggle with View 3 when thinking about whether another party has a corresponding right that qualifies as an asset. Further, we think that View 3 needs to be better articulated and examples need to be provided that better distinguish the two views. If it is not possible to do so, we think that View 3 is not a sufficiently robust concept and should be discarded.

Other comments – Question 7

15. We have no other comments.

Section 4 Recognition and derecognition

Recognition – Question 8

16. We agree that all assets and liabilities should be recognized (with limited exceptions being addressed at a standards level). If the definitions of the elements are valid, there must be a presumption to recognize all items that meet those definitions.

17. We think that Chapter 3 of the existing *Conceptual Framework* provides the basis for the IASB to determine and explain any departures from concepts in the *Conceptual Framework*. However, such departures should be standard level decisions. Although it might be helpful to remind stakeholders of how the concepts in Chapter 3 could be applied at a standards level by specifying recognition criteria, an explicit exception in the *Conceptual Framework* is unnecessary and may suggest to some that the concepts in Chapters 3 can only be applied when explicitly referenced.

18. As we have stated elsewhere in this response, we think exceptions should not be included in the *Conceptual Framework* but considered and justified at a standards level. We think that recognition criteria could be introduced at a standards level when necessary without requiring an exception in the *Conceptual Framework*. We think that the material for the Exposure Draft should be phrased to include a broad explanation that allows for the IASB to specify recognition criteria at a standards level when necessary.

19. Should the IASB not agree with our view, we offer the following comments with regards to the exceptions noted in paragraph 4.25 of the Discussion Paper. We find it difficult to envision how recognizing an item that meets the definition of an asset or liability could provide information that has no relevance to a user (i.e., the first half of (a) in paragraph 4.25). However, we agree that two reasons the IASB may decide at a standards level that an asset or liability should not be recognized are if recognition does not provide users with sufficiently relevant information to justify the cost (i.e., the second half of (a)) or no measure would faithfully represent the asset or liability (i.e., (b) in paragraph 4.25).

20. Further, we think a distinction needs to be made at a standards level between recognition (and derecognition) and a nil carrying amount.

Derecognition – Question 9

21. We agree that an entity should derecognize an asset or liability when it no longer meets the recognition criteria and support the control approach described in paragraph 4.36(a) of the Discussion Paper. However, as noted above, we think a distinction needs to be made at a standards level between derecognition and a nil carrying amount.

22. We struggle with the notion of an entity retaining a component of an asset or liability because the element definitions focus on rights and obligations. We think this discussion implies a different unit of account and demonstrates that unit of account should be addressed in the framework as explained further in our response to question 24 below (see paragraphs 100-106). If unit of account is only addressed at a standards level, we agree that the IASB must also determine at a standards level how to portray the changes when an entity retains only some of the rights (obligations) of a previously recognized group of rights (obligations).

Section 5 Definition of equity and distinction between liabilities and equity instruments

23. The majority of proposals in Section 5 of the Discussion Paper (other than question 10(a) and part of question 10(b)) cover a range of accounting issues from the application of the definitions to measurement and presentation. We think that it would be more appropriate to deal with these issues at a standards level rather than in the *Conceptual Framework*.

24. We found this section challenging to assess because we could not identify what parts would be included in the *Conceptual Framework* from material that was provided to explain the proposals and implications of the alternatives. As a result, it was very difficult for us to provide constructive responses to the questions asked. Therefore, we have responded to the questions primarily to assist the eventual consideration of the issues at a standards level.

Equity definition – Question 10(a)

25. We agree with the IASB's preliminary view that the *Conceptual Framework* should retain the existing definition of equity as "the residual interest in the assets of the entity after deducting all its liabilities".

Consequences of the liability definition – Question 10(b)

26. We agree with the concept that the IASB should use the definition of a liability to distinguish liabilities and equity instruments. However we think the two consequences of that view, that obligations to issue equity instruments are not liabilities and that obligations that will arise only on liquidation of the reporting entity are not liabilities, is guidance that the IASB should consider at a standards level rather than identified as concepts in the *Conceptual Framework*.

27. Several practitioners we consulted indicated that they spend a significant amount of time distinguishing liabilities from equity instruments given the complex nature of these instruments. Some users of financial statements expressed the need for better information about, and improved classification of, claims that identify the priority in which they will be settled. We think that they are asking for this information given the numerous and complex exceptions in IAS 32 *Financial Instruments: Presentation*.

28. Several academics, however, emphasized the importance of considering the choices an entity can make when issuing derivative contracts, including whether the entity has the ability to issue a derivative contract to settle an obligation or whether the entity has choices on how it can settle the contract. When an entity can decide whether to settle in cash or equity, it will report fewer liabilities. Some academics think such reporting does not provide relevant information or faithfully represent arrangements that are to finance operations or are likely to result in cash payments. Such classifications reduce reported leverage and can affect decisions made by financial statement users.

29. We think that using the liability definition to distinguish liabilities and equity instruments is the first step or guiding concept to determine how to classify an instrument. That proposed classification then needs to be assessed through the application of the qualitative characteristics (i.e. does the classification provide relevant information, is the depiction of claim represented faithfully and how can the usefulness of the information be enhanced) and the cost constraint. That analysis, including assessing implications of those classifications, needs to be fully assessed at a standards level.

30. We recommend that the IASB propose a targeted standards level project to remove or reduce the inconsistencies within IAS 32 as part of its next agenda consultation.

Subsequent measurement of equity – Question 10(c)

31. We agree that the *Conceptual Framework* should not prescribe a specific format for the statement of changes in equity. Redesigning the statement of changes in equity to display updated measurements of equity claims is a new and innovative idea. "Wealth transfer" misrepresents the nature of the change being reported. When the market value of a share in an entity changes, the value of shares owned by existing shareholders and written options both change. Thus, the existing shareholders are no worse off and did not transfer anything to the option holder as no exchange occurred between two parties.

32. Many stakeholders we consulted challenged the need for the proposal given that:

    > "General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity." (Paragraph OB7 of Chapter 1).

33. They question reporting fair value changes in written options, warrants and other similar instruments classified as equity given the uncertainty of whether those instruments may be exercised. Others objected to updating the measurement of some but not all equity claims because it is incomplete and potentially misleading.

34. Some stakeholders thought that more work at a conceptual level could develop a simplified approach to when and how measurements of equity claims are updated. For example, the measurement of written options could be updated only when the option is exercised with the difference between that market price and the total consideration received for the instrument (i.e. the premium received plus the exercise price) reported in the statement of changes in equity. Such an approach would be consistent with the requirements in IFRS 3 *Business Combinations* and IAS 32 (although not stated explicitly) when shares are used as consideration.

35. Several stakeholders expressed support for reallocating the total net assets of the entity among all equity claims. The statement of changes in equity would report a revised carrying value of each equity class by allocating the carrying value of the net underlying assets to each class. In essence, it would provide a hypothetical liquidation value of an entity, rather than revised assessments of the value of some of the claims.

36. Stakeholders we consulted thought that updating the measurement of equity claims, i.e. using a current measurement or an allocation approach, would not likely reduce the challenges and concerns with distinguishing liabilities from equity instruments. Several preparers, auditors and academics questioned whether the benefits of the information to financial statement users would exceed the cost of updating the measurement of equity instruments. The views of financial statement users varied. Lenders saw little merit to the additional information, while equity investors thought it may be helpful.

37. On balance, we think that the idea of updating measurements of equity is worth further consideration. It is a proposal that we include in the second group of topics that warrant further research. We think that the IASB needs to conduct a more detailed assessment of the need for, and benefits of, this proposal before proceeding.

Most subordinated class of instruments – Question 10(d)

38. Permitting an entity that has not issued any equity instruments to treat the most subordinated class of instruments as if it were an equity claim would be an exception. As we have stated previously, the *Conceptual Framework* should only set out concepts that are to be applied when developing standards. Exceptions to those concepts should only

be considered at a standards level after applying the qualitative characteristics and the cost constraint.

39. We think that more research and analysis is needed at a standards level. The follow-on consequences of classifying the most subordinated class of instruments as equity would need to be assessed and agreed upon, such as whether the entity would report earnings per share, before deciding to provide this exception.

Section 6 Measurement

Take a two-step approach

40. We think that the measurement section should clearly articulate concepts and principles that set out necessary and sufficient criteria to determine the measurement basis for categories of assets and liabilities. This section currently proposes guidelines for improving measurement practices in IFRSs and makes general statements of when specific measurement bases will "normally" or are "likely" to be used based on past practices. Including these guidelines and statements in the *Conceptual Framework* would ingrain current practices without rigorous analysis, discussion of the rationale or consideration of the consistency of those positions. This could impede development of the underlying concepts and principles that are the essence of a conceptual framework.

41. In particular, we think it essential that the framework deal explicitly with the risk that an entity's bias could affect a measurement, either through making optional changes (as noted in paragraph 6.24 of the Discussion Paper) or determining estimates when there is uncertainty. In academe, moral hazard is a term used to describe situations when a party has the opportunity to take risks or act with "self-interest-seeking with guile", to the detriment of another. A faithful representation of a measurement requires that it be neutral or unbiased. The attributes of some measurement bases could reduce the opportunity for bias to be exercised. The failure to deal explicitly with moral hazard would seriously undermine the credibility of the *Conceptual Framework* particularly as it relates to measurement.

42. For example, when there is wide range of possible outcomes for a liability, requiring a best estimate to be determined by using a probability-weighted expected cash-flow measure would enable the entity to be more objective than requiring the selection of the single most likely outcome that it expects to pay. In other situations, when the uncertainty is so high that a cash-flow measurement would be too subjective, it may be necessary to consider whether the item should be recognized, if recognized whether it should be measured at cost and whether it should be remeasured at subsequent dates, or whether information about the nature and uncertainty of the item should be disclosed. Some of these situations may be considered when determining whether a measurement will provide a faithful representation of relevant information about the item or require the use of more verifiable inputs. Academics and other stakeholders we consulted were very concerned

that the Discussion Paper did not identify explicitly the need to consider the risk of bias when there is subjectivity in measurements.

43. A significant amount of thought, analysis and discussion is needed to develop measurement concepts and principles that will be useful and effective for developing principle-based measurement requirements in new and amended standards. Therefore, we recommend that the IASB undertake a two-step approach to improve the measurement guidance in the *Conceptual Framework*.

First Step – develop interim guidance

44. As part of this project and on the same timeline, the IASB should develop revised but limited measurement guidance that can be included in the *Conceptual Framework* until rigorous measurement concepts and principles can be developed. This measurement guidance could include:

    (a) the objective of measurement as proposed (see response to question 11(a) or paragraphs 51-52);

    (b) the requirement that the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost (see response to question 11(f) or paragraph 65);

    (c) descriptions of the measurement bases or categories that should be considered when determining how to measure an asset or a liability; and

    (d) the attributes of the information the different measurement bases or categories portray about an item, which should be assessed in standards level projects when determining the measurement basis that would provide the most relevant information to financial statement users.

45. This first step would describe the measurement bases and identify the information attributes about measurements that would provide a common starting point for assessing how to measure an item at a standards level. We think that such revised yet brief conceptual measurement guidance could be developed without significant effort by evaluating and revising existing descriptions of measurements bases, as needed. For example, the IASB could make use of the descriptions of measurement bases set out in past published research on measurement, such as:

    (a) the Institute of Chartered Accountants in England and Wales "Measurement in Financial Reporting: Information for Better Markets Initiative" issued in 2006;

    (b) the IASB Discussion Paper "Measurement Bases for Financial Accounting – Measurement on Initial Recognition" (prepared by staff of the Canadian AcSB) issued in 2005; and

    (c) the International Public Sector Accounting Standards Board "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities:

Measurement of Assets and Liabilities in Financial Statements" issued November 2012.

Thus, the focus of the first step would be on explaining how, and to what extent, the different measurement bases convey relevant information about the amount, timing and uncertainty of the cash flows associated with the asset or liability, including market risks like interest rate risk and price risk.

46. The revised guidance should not include:

(a) many of the IASB's preliminary views that are guidelines for improving measurement practices in IFRSs (such as not using a single measurement for all assets and liabilities), because they describe an intended result rather than identifying when one measurement basis should be used instead of another basis.

(b) general statements of when specific measurement bases may be used because common practices do not belong in a conceptual framework.

(c) the description of present value in the current *Conceptual Framework* because present value is a measurement technique rather than a measurement basis.

Second Step – develop measurement concepts

47. We recommend that research on measurement be the first topic that the IASB undertakes as part of its new research program. In-depth research is needed into what the conceptual underpinnings should be for measurement.

48. This research will take time and resources. We think that it would not be possible to make significant progress in this area within the IASB's current project timeline. Accordingly, we recommend that this research be undertaken separately over a longer period of time.

49. This research should:

(a) identify the information needs of different users of financial statements and how they use information;

(b) assess the usefulness of reported information in predicting future cash flows and identify the measurement basis or bases that provide the most useful information about different assets and liabilities;

(c) identify the other qualitative characteristics, including the cost constraint and possibly other factors, that should be considered when selecting a measurement basis and the inter-relationships of those factors;

(d) involve rigorous evaluation of each measurement family based on the qualitative characteristics, including the cost constraint;

(e) develop concepts that would result in identifying characteristics that are necessary and sufficient to portray the measurement of assets and liabilities with similar attributes in a consistent manner;

(f) assess the effect of moral hazard in measurement and how the selection of a measurement basis could reduce the opportunity for bias in measurements;

(g) develop conceptual rationale for when assets and liabilities should be remeasured and whether and how they should be assessed for impairment when they are not remeasured; and

(h) generate discussion, debate and a better understanding of views between the IASB and its stakeholders in order to advance thought about measurement in financial reporting.

50. We also think that an explicit discussion of moral hazard may be more effective than reinstating prudence or the need to exercise a "degree of caution" when setting standards. It may also resonate with stakeholders who think stewardship requires a higher profile (see overall response to question 11 or paragraphs 41-42).

Objective of measurement – Question 11(a)

51. We agree that the objective of measurement should be based on the objective of financial reporting. We support the IASB's preliminary view that a measurement basis should be selected based on the usefulness of the information to investors, lenders and other creditors in making decisions about providing the entity with resources. The usefulness of the information should be assessed based on the relevance of a measurement that faithfully represents information about:

(a) the resources of the entity, claims against the entity and changes in resources and claims; and

(b) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.

52. We think that including the objective of measurement in the *Conceptual Framework* would be a significant improvement.

Single measurement basis – Question 11(b)

53. We agree that a single measurement basis for all assets and liabilities may not necessarily provide the most relevant information for users of financial statements. Different measurement bases portray or quantify information about assets and liabilities differently. We think that a measurement basis should be selected through determining how to convey relevant information about the amount, timing and uncertainty of the cash flows associated with a given asset or liability.

54. We think that the preliminary view as expressed is an acknowledgement of the IASB's intention that it "may" not require a single measurement basis for all assets and liabilities. Such a statement does not require or limit future measurement decisions the IASB may

make. As outlined previously, we recommend that the *Conceptual Framework* should instead set out:

(a) the measurement bases or categories that should be considered when determining how to measure an asset or a liability; and

(b) the attributes of the information the different measurement bases portray about an item that should be assessed as part of determining the measure that would provide the most relevant information to financial statement users.

55. The basis for conclusions for the measurement chapter of the *Conceptual Framework* could explain that the IASB included multiple measurement bases or categories because the IASB recognizes that different measurement bases can provide relevant information. Further research is required to determine which measurement basis or bases best serve the needs of financial statement users for various categories of assets and liabilities.

Information on the statement of financial position and the statement(s) of profit or loss and OCI – Question 11(c)

56. We agree that the information a measurement would provide in both the statement of financial position and the statement(s) of profit or loss and other comprehensive income (OCI) should be considered when selecting how a particular item should be measured. Considering the information a measurement provides at a point in time and changes over time adds discipline to the process of deciding what measurement basis provides users of financial statements with the most relevant information. For example, the information attributes that measurement bases portray in the statement of financial position (at a point in time) and in the statement of performance (changes over time) could be described in the framework.

57. This preliminary view acknowledges one important consideration that should be assessed when determining how to measure an asset or liability. Yet, there are other factors that should be considered that could result in selecting a different measurement basis, such as the ability to represent information faithfully, that were not discussed adequately in the Discussion Paper. Thus, we recommend that the IASB conduct research to identify all the various considerations or factors that should be assessed (see the second step of the proposed two-step approach in the overall response to question 11 or paragraphs 47-50).

58. We think that this preliminary view also implies that it may be acceptable to measure an item using different bases in each statement when the information in those statements would provide more relevant information to users of financial statements. In concept, we think that changes in assets and liabilities result in income and expenses that represent an entity's performance. The reference to reporting information in profit or loss and OCI would permit presenting some changes in assets and liabilities in OCI.

59. We support the use of OCI from a practical perspective because it has enabled some assets and liabilities to be measured using a more relevant basis on the statement of

financial position and the changes, or a portion of those changes, to be presented in the statement of OCI (see responses to questions 20 and 21 or paragraphs 82-92). Therefore, we recommend that this view be expressed in terms of how changes in assets and liabilities are reported but should not be included in the *Conceptual Framework* because the preliminary view is not a concept. We think that material on the use of OCI, including this view, should be provided outside the *Conceptual Framework*. For example, the IASB could acknowledge in the basis for conclusions that it may decide when developing new and amended standards that some changes may be reported in OCI.

Relevance of a measurement – Question 11(d)

60. We think that the IASB should not form a view on how to assess the relevance of a particular measurement without additional research.

61. The IASB's preliminary view narrows the focus for assessing the usefulness of financial reporting from "assess[ing] the prospects for future net cash inflows to an entity" (paragraph OB3) to determining how "an asset or a liability contributes to those future cash flows". Yet, when applying this proposed overarching view to determining how to measure financial assets and financial liabilities (see paragraph 6.19 of the Discussion Paper), the IASB acknowledges that this overarching view "may not provide information that is useful when assessing prospects for future cash flows." Having to propose an exception demonstrates that this preliminary view requires further thought.

62. We also question the merits of further extending this view in the context of all assets and liabilities because the preliminary view is not complete. It does not identify how the selection of the measurement would consider whether that relevant measurement could be represented faithfully.

Number of different measurement bases and unnecessary changes – Question 11(e)

63. We agree that the number of different measurements used in financial statements should be the smallest number necessary to provide relevant information. We also agree that unnecessary measurement changes should be avoided and necessary measurement changes should be explained.

64. We think that this preliminary view is a goal that the IASB is striving to achieve. Without clear descriptions of each measurement category and assessment of the information attributes of each measurement category, there is no basis for achieving this goal. We think that goal can be achieved through the development of rigorous measurement concepts. Therefore, we recommend that this preliminary view be expressed in the Basis for Conclusions rather than in the *Conceptual Framework*.

Benefits versus costs – Question 11(f)

65. We agree that the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost. Including this preliminary view in the *Conceptual Framework* would make explicit the need to consider the cost constraint when determining how to measure an item.

Subsequent measurement – Questions 12 through 14

66. We recommend that the IASB not further develop these preliminary views but instead undertake a two-step approach to work towards developing more robust measurement concepts (see overall response to question 11 or paragraphs 40-50).

67. The IASB's preliminary views propose common ways to measure different types of assets and liabilities in a manner similar to the existing material in the *Conceptual Framework* for assets and liabilities in general. Overall, the material accommodates all measurements rather than removing options, is vague and does not restrain or guide a standard-setter in any way. While some statements may seem plausible, there is no supporting conceptual explanation for them. We and most, if not all, stakeholders we consulted are concerned that including these statements in the *Conceptual Framework* would enshrine current practices and make it difficult to develop measurement concepts.

68. We are also disappointed that the Discussion Paper did not outline or refer to the results of the IASB's past research and public consultations, especially in the context of how to measure derivative instruments.

69. For these reasons, we disagree with the IASB's preliminary views regarding subsequent measurement of assets, liabilities, financial assets and financial liabilities.

Other comments – Question 15

70. We think that the IASB should replace the material on measurement in the existing *Conceptual Framework*. We recommend a two-step approach. The IASB should consider including interim guidance that provides a common starting point for assessing how to measure an item and undertake research to develop measurement concepts (see overall response to question 11 or paragraphs 40-50, including suggestions on what the interim guidance could contain in paragraph 44).

Section 7 Presentation and disclosure

Scope and content of presentation and disclosure guidance – Question 16

71. While recognition and measurement focus on the determination of what information should be included in financial statements, presentation and disclosure focus on the important issue of how that information should be communicated to investors, lenders and other users of financial statements. Improving the quality of this communication, especially the notes to the financial statements, is important and we welcome recent initiatives by the IASB in that regard. These various IASB initiatives, including the relevant content of the *Conceptual Framework*, must be well co-ordinated so the resulting guidance supports disclosures that are consistent and meet user needs in a cost efficient manner. It was difficult to understand from the Discussion Paper what is intended to be included in the *Conceptual Framework* on presentation and disclosure and how that would relate to other steps the IASB is planning regarding presentation and disclosure. Some of the content of this chapter clearly does not belong in a conceptual framework, such as the discussion of financial statements in an electronic format. The other material is not consistent with our view that the *Conceptual Framework* should focus on concepts.

72. Overall, we think that this section of the Discussion Paper is not sufficiently developed to form part of the *Conceptual Framework*. Significant conceptual issues that are not addressed in the Discussion Paper include:

    (a) The scope of information that should be included in financial statements.

    (b) The type of information that should be required to be included in the primary statements versus in the notes. This includes the extent of disaggregation of information in the primary financial statements.

    (c) A framework of user needs that standard setters (and preparers) should focus on (including key categories of user needs).

    (d) Guidance on how the cost constraint applies to disclosure so as to prevent or minimize disclosure overload.

    (e) A discussion about whether there should be any other constraints on disclosure (e.g. competitive harm).

73. We agree that the primary financial statements are the statement of financial position, the statement of profit or loss and the statement of OCI, the statement of changes in equity and the statement of cash flows. We also agree with the objective of primary financial statements in paragraph 7.17 of the Discussion Paper but note that this definition is not useful without more consideration of how information should be summarized.

74. The material on classification and aggregation in paragraphs 7.20 to 7.28 is largely descriptive in nature. The only material that discusses how information should be classified in the primary financial statements is paragraph 7.26 which provides examples of how information might be classified (function, nature, measurement basis). This would

be of little use to the IASB or a preparer or auditor in making specific decisions on the degree or method of summarization.

75. We agree that, conceptually, offsetting should not be permitted in financial statements. As we have stated elsewhere in this response, we do not think exceptions should be included in the *Conceptual Framework.* Exceptions should be considered and justified at a standards level. We also agree that no primary financial statement should have primacy over other primary statements.

76. We agree with the objective of the notes to the financial statements as expressed in paragraph 7.33. However paragraph 7.34 goes on to refer to understanding how actions taken by management protect the entity's assets from unfavourable effects of economic factors such as price and technical change. This is a very broad statement and demonstrates the need to identify the boundaries of the information that is within the scope of financial statements. Paragraph 7.35 addresses the scope of the notes. However, it is a list of some things the IASB would "normally consider" and includes "information about the reporting entity as a whole, to the extent necessary to understand… how effectively the entity's management and governing board have discharged their responsibilities to use the entity's assets" as well as "the nature and extent of risks arising from the entity's assets and liabilities". This does not address the scope of the notes in a meaningful way – indeed these statements open the door to disclosures that many would consider well beyond the scope of financial statements. The other items listed in paragraph 7.35 are more specific, but there is no link provided to show how they relate to the objective of the notes or any evidence that this list is comprehensive. A conceptual framework should clearly show how the more detailed aspects flow from the objectives and higher level concepts.

Materiality – Question 17

77. We agree that materiality is well discussed in Chapter 3 of the existing *Conceptual Framework* and that there is no need for the IASB to amend or add to that guidance in the *Conceptual Framework*. Materiality is a pervasive consideration that applies to all aspects of financial reporting. Including it in the section of the *Conceptual Framework* that addresses presentation and disclosure could imply that it is less relevant to other parts of the *Conceptual Framework.*

78. We agree that the application of materiality to presentation and disclosure is not always well understood. Consistent with our view that the *Conceptual Framework* should focus on concepts, any additional guidance or educational material on this topic should be outside of the *Conceptual Framework.*

Communication principles – Question 18

79. We think the IASB can support effective presentation and disclosure by the way in which presentation and disclosure requirements are specified in standards. Standards should not impede effective communication. We agree with the communications principles in paragraph 7.50 of the Discussion Paper and think that they would be helpful in developing requirements at a standards level that support improved presentation and disclosure in financial statements.

Section 8 Presentation in the statement of comprehensive income—profit or loss and other comprehensive income

Require a total or subtotal for profit or loss – Question 19

80. Generally speaking, the *Conceptual Framework* should not require specific totals or subtotals in financial statements because they are not a fundamental concept or element of financial statements. Although profit or loss is a total or subtotal, it is a residual measure similar to the concept of equity. Lenders, equity investors, regulators, preparers and auditors we consulted all agree strongly that the total or subtotal for profit or loss is one of the most widely used pieces of financial information. Its importance is reinforced by its use to derive earnings per share and other performance metrics.

81. Therefore, we think that the *Conceptual Framework* should acknowledge that a total or subtotal of profit or loss can provide decision useful information. The determination of items to be included in profit or loss (or other totals or subtotals) should, however, be a standards level decision.

Permit or require recycling – Question 20

82. We do not agree with the IASB's preliminary view that some items of income or expense previously recognised in OCI should be permitted or required to be recognised subsequently in profit or loss, i.e. recycled. We think that the IASB should require all items to be recycled if they are recognized in OCI.

83. In the long term, we think that there should be one overall performance measure that does not present some income and expenses in profit or loss and others in OCI. This aspirational view is based on the fundamental principle that "changes in a reporting entity's economic resources and claims result from that entity's financial performance" (paragraph OB15) other than changes resulting from transactions with equity investors (paragraph OB21). Academics we consulted supported that view based on the principle of "clean surplus", a theory that links accounting and finance practices[1].

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[1] "Valuation and Clean Surplus Accounting for Operating and Financial Activities" study by Gerald Feltham and James Ohlson in 1995 sets out the clean surplus theory. The theory illustrates a way of calculating the

84. However, we think that the use of OCI is a practical decision rather than a conceptual matter. We acknowledge that standard setting involves considering conflicting objectives of different stakeholders and developing generally accepted standards. In some circumstances, we accept that it might be necessary for the IASB to decide to report some income or expenses in OCI at a standards level in order to make improvements in financial reporting. For example, we support the use of OCI when it would enable some assets and liabilities to be measured using a more relevant basis on the statement financial position, and the changes in those assets or liabilities, or a portion of those changes, to be presented in the statement of OCI.

85. When assessing whether to report some income and expenses in OCI, we think that the IASB should consider an entity's ability to make decisions that result in recycling a gain or loss in profit or loss in order to report a more favourable position. If the use of OCI is considered on balance to provide the more relevant information to financial statement users, the IASB should consider presentation and disclosure requirements to identify and explain gains and losses that have been recycled from OCI. Such information could help to reduce or detect opportunistic behaviour.

86. In time, we think that the information value of items reported in OCI will be better understood and considered when assessing an entity's overall performance. In part, our view is based on the importance that some financial statement users place on assessing income and expenses reported in OCI to understand an entity's past performance and better predict its future cash flows. Therefore, we think that recycling all items reported in OCI is important. While recycling may be complex, recycling is a necessary consequence that arises from using OCI.

Use of OCI – Question 21

Defining "financial performance" or OCI

87. All stakeholders we consulted were disappointed that the Discussion Paper did not propose to define "financial performance" or identify the necessary and distinguishing characteristics of income and expenses that could be reported in OCI. Instead, the Discussion Paper developed rationale to identify the types of income and expenses the IASB may consider reporting in OCI.

88. Given our view that the use of OCI is a practical approach used to improve financial reporting and the wide range of views of how best to report an entity's performance, we think the IASB should not undertake work to define financial performance or describe OCI at this time. The IASB should use its resources to further develop other areas of the *Conceptual Framework.*

market value of a firm, and ultimately the security returns, by means of balance sheet and income statement components and how these statements reconcile in order to anticipate future earnings.

89. The proposals provide a practical and systematic approach that will help the IASB when deciding whether to report items in OCI when developing standards. We think that the discussion of OCI and this guidance should not be included in the *Conceptual Framework* because the use of OCI is not a concept in financial reporting but an exception to a concept. We recommend that the material be issued outside of the *Conceptual Framework*.

90. In addition, we also agree that only the IASB should decide when OCI should be used. Issuing the material outside the *Conceptual Framework* would enable the *Conceptual Framework* to assist the IASB and other parties equally.

Narrow or broad approach

91. We support the broad approach 2B but think that transitory remeasurements should be required to be recycled (see response to question 20 or paragraphs 82-86).

92. We also recommend reassessing the name and description of "mismatched remeasurements" to avoid using the notion of matching as a basis for using OCI. We are concerned that the matching logic could be used to defer expensing items in profit or loss and result in a broader use of OCI. The IASB could consider describing this category as "linked items", as the income and expenses on a linked set of assets and liabilities are not always remeasured in profit or loss in the same period, absent the application of a linking notion. Thus, reporting these items together would faithfully represent the linked nature of these items. We think that further thought is needed to identify the type of linked arrangements that would or would not qualify.

Section 9 Other issues

Chapters 1 and 3 of the existing* Conceptual Framework *– Question 22

93. We agree that the IASB should not reconsider Chapters 1 and 3 of the existing *Conceptual Framework.* These chapters were completed only three years ago and were subject to full and extensive due process. The issues of stewardship, reliability and prudence were fully considered by the IASB with input from those supporting the changes and those opposing them. At that time we supported the changes for the reasons explained in the Basis for Conclusions on Chapter 3. We are not aware of anything that has occurred since that time that might change our view or that should change the IASB's view.

94. We are particularly concerned about re-introducing prudence into the *Conceptual Framework* for the reasons stated in the Basis for Conclusions on Chapter 3 and reproduced in paragraph 9.18 of the Discussion Paper. Specifically, we are concerned that prudence is often understood to require different recognition thresholds for assets and liabilities. This can result in recognizing liabilities that have a lower degree of certainty than is required to recognise assets. We fail to see how this can be consistent with neutrality, which is one of the three enhancing characteristics of the fundamental

qualitative characteristic of faithful representation. We think that neutrality is an essential aspect of the credibility of financial statement information and are concerned that re-introducing the concept of prudence into the *Conceptual Framework* would endorse bias.

95. Paragraph 9.19 notes that some support the need for prudence "to counteract the effect of over-optimistic management estimates". This argument raises the issue of moral hazard. Although the concept of moral hazard associated with financial reporting is well accepted and supported by extensive academic literature, it is not addressed in the Discussion Paper. As noted in our responses to earlier questions, we agree that all assets and liabilities should be recognized (with limited exceptions being addressed at a standards level and after assessing materiality and the cost constraint). Consequently, we think moral hazard needs to be explicitly addressed in the context of measurement (see overall response to question 11 or paragraphs 41-42).

Business model – Question 23

96. The Discussion Paper does not define "business model". One view might be that the business model is a choice made by management on how to manage the entity's assets and operations. We would be concerned if the accounting for assets (and liabilities) could be determined based on management intent. This would permit an entity to decide to manage assets in a certain manner in order to achieve a desired accounting result. It would also affect comparability between similar entities if the respective managements chose different business models.

97. We think that the type of business may determine the most appropriate accounting. Examples in current IFRSs are broker-dealers, investment companies and investment properties. The determining factor here is the business the entity is engaged in, which is a matter of fact rather than of management intent.

98. Whether an item is recognised as an asset (or liability), or when it is recognized, should not be affected by the type of business or the business model selected by management. We agree that the type of business might affect the choice of the basis of measurement. The examples in the previous paragraph primarily relate to measurement. However, we think that this will be rare and should be driven by the concepts in the *Conceptual Framework* for the determination of the measurement basis.

99. The business model may play a role in presentation and disclosure. The business model will often reflect management's views of the risks associated with different assets. Differences in risk affect aggregation/disaggregation in the financial statements and the level of detail provided in the notes to the financial statements. For example, the management approach underlying segment reporting is based on management's business model.

Unit of account – Question 24

100. Unit of account is a fundamental and pervasive issue in standard setting. While we agree that the unit of account will be determined at a standards level, we think it is important that the *Conceptual Framework* address the concepts associated with unit of account to ensure that new and revised standards address unit of account in a systematic, rational and consistent manner. The following paragraphs outline some aspects of unit of account that we believe need to be considered.

101. We think a key concept is that there are four inter-related unit of account issues. These are the unit of recognition, the unit of measurement, the unit of presentation and the unit of disclosure.

102. The unit of recognition (and derecognition) defines the boundaries of an element. The unit of account for initial recognition usually coincides with the physical or contractual boundaries of whatever is transferred. However, this may not be true when different portions of the item transferred contribute to the future cash flows of the reporting entity in different ways. For example cash flows associated with different parts of an item may be fixed, variable or contingent and other factors may also affect the timing and uncertainty of future cash flows. The unit of account changes as the item is used in the entity's value-producing process so context needs to be considered.

103. The unit of measurement is not necessarily the same as the unit of recognition. In certain circumstances, measurement may only be possible at a group level. For example, asset impairment may have to be carried out for a cash-generating unit rather than for individual assets. As a practical matter, grouping for measurement is also appropriate when the item is economically indistinguishable from other similar items, either because items are fungible or individually insignificant. However, such aggregation of individual items would generally not affect the total amount at which the items are measured.

104. The unit of presentation is generally at a more aggregated level than the unit of recognition or the unit of measurement. Offsetting is a unit of presentation issue as is the debate about presentation by nature or by function.

105. There are two unit-of-account issues in determining disclosures. Disclosures are sometimes used to provide an alternative view to information presented on the face of the statements. For example, risk disclosures aggregate portions of a number of similar and dissimilar elements. Risk exposures are a separate unit of account for disclosure purposes. In other cases, disclosures provide more granular information than considered appropriate for presentation.

106. We think that more research is needed to develop concepts level thinking on unit of account that could be included in the *Conceptual Framework* and that this should be undertaken as part of the coordinated research on conceptual framework topics that we propose elsewhere in this response.

Going concern – Question 25

107. We are not aware of any other situations where the going concern assumption might be relevant.

Capital maintenance – Question 26

108. We agree that the IASB should include the existing descriptions and the discussion of capital maintenance concepts in the revised *Conceptual Framework*, largely unchanged, at this time. The difference between financial capital maintenance and physical capital maintenance can be substantial. However, the quite limited material on capital maintenance concepts in the current *Conceptual Framework* is not an aspect that is currently causing difficulty. The IASB's resources should be focused on other aspects of the *Conceptual Framework* as discussed elsewhere in our response.

Additional Comments

Transition

109. The Discussion Paper notes that a new conceptual framework would not override existing standards but would be used in the development of new standards. It does not otherwise discuss transition issues. We think that issuing a new conceptual framework with significant differences from the existing *Conceptual Framework* could raise transition issues for preparers, auditors and other stakeholders.

110. The *Conceptual Framework* is used in determining how to account for a transaction in the absence of a standard that specifically applies to the transaction or event. Certain standards also use terms that are only defined in the *Conceptual Framework.* The transition question arising is whether the new *Conceptual Framework* should be used in conjunction with a standard developed using the current *Conceptual Framework* – or should one be required to look back to the *Conceptual Framework* in place when the standard was developed. This issue becomes more complicated if a standard developed under the current *Conceptual Framework* is amended after the new *Conceptual Framework* is issued. A related question is whether an accounting policy developed using the existing *Conceptual Framework* would have to be reconsidered if it is not consistent with the new *Conceptual Framework.*

111. We think the IASB should identify significant conflicts between the new *Conceptual Framework* and existing standards as a first step to determining whether and what transition guidance will be required.

Professional judgment

112. In developing a standard the IASB must decide how much detailed guidance to include. Implicit in this decision is a view of the professional judgment that preparers, auditors and other stakeholders can be expected to apply. It is also important for preparers, auditors and other stakeholders to understand the level of guidance generally included in an IFRS and the IASB's expectations of them in terms of applying professional judgment. We therefore think that the *Conceptual Framework* should address professional judgment.